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State Government and the Global Economy

Introduction

With the elimination last year of the state's lead trade-promotion entity, the Technology, Trade and Commerce Agency, California has been provided an opportunity to rethink how the state should most appropriately support California businesses to compete in the international economy. Policymakers in both the Legislature and the Schwarzenegger administration may want to review the history of what led to creation of California's once-sizable array of trade programs, the establishment of a Cabinet-level agency dedicated to trade and economic development, and the reasons for the demise of that agency before embarking on any new international initiatives.

Without a doubt, the state and global economies and public and private networks of trade programs available for businesses have been altered in significant ways since the era when most of the agency's programs were created over 20 years ago. Controversies over the function and value of the state's international programs, most particularly the foreign trade and investment offices, may have been an obstacle to the development of a coherent and market-driven state international-development strategy.

The Technology, Trade and Commerce Agency was disbanded at the end of 2003, and a number of developments indicate that legislators are interested in asking what comes next. In December 2003, Senator Betty Karnette, chair of the Banking, Commerce and International Trade Committee's Subcommittee for European Trade, held a hearing in Long Beach to review practical and effective ways of promoting international trade following the elimination of the agency. In the Assembly, a Select Committee on California's Foreign Trade Offices, chaired by Assemblyman Leland Yee, was named at the end of the 2003 legislative session.

SOR and International Trade

The Senate Office of Research has chronicled the history of California's international trade programs over the years beginning with the publication in 1982 of *California's International Trade* by Lou Angelo, John Griffing's *The Other Deficit: A Review of*

International Trade in California and the U.S., and, in 1984, Nick Vucinich's *Tapping New Markets: California's Role in Promoting International Trade* in 1993.

SOR held a roundtable discussion in February 2002 that included journalists, trade consultants, representatives of trade associations and world trade centers, and scholars from the University of California and the Public Policy Institute of California on trade issues surrounding Senator Richard Polanco's SB 1683, the proposed California International Trade and Investment Act of 2002.[1]

Key recommendations to come out of this roundtable included:

- Putting more emphasis on how California engages in the global economy as opposed to placing a more narrow emphasis on how California can increase exports.

- Dealing with the broader policy implications and enormous relevance of federal trade policy to California.

- Recognizing the importance of infrastructure, such as ports and airports, for trade.

- Tapping into the expertise on international issues that exists in California's universities, law schools and many policy institutes.

- Improving coordination among the state and local World Trade Centers, the Centers for International Trade Development at the community colleges, and U.S. government offices.

- Encouraging the then-existing California State World Trade Commission to coordinate its activities with the California Economic Strategy Panel. The panel has looked at regional economies in the state and clusters of key industries. It has reviewed how those clusters are defined, their needs and growth potential -- providing a data base to drive training, economic development and loan programs.

Origins of California's International Trade Programs

While there were attempts to establish offices to promote international trade as early as the Pat Brown administration in the 1960s, the origins of California's international business programs date from the 1977 creation of the Department of Economic and Business Development and within it an Office of International Trade. The Department of Economic and Business Development (later the Department of Commerce) was established by SB 29 (the Holmdahl-Lockyer-Rains Act), which was signed by Governor Jerry Brown.

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[1] As chairman of Senate Budget and Fiscal Review Subcommittee No. 4, Senator Polanco authored his bill in part to respond to a state audit of the Technology, Trade and Commerce Agency in 2001. The bill was held on the suspense file in the Assembly Appropriations Committee at the end of the legislative session.

However, an even greater state involvement in international trade stemmed from two developments that took place in 1982, the last year of the Jerry Brown administration. At that time, California was facing a then-astounding budget deficit of $2 billion. The nation and state were mired in a recession and the issue of trade deficits was becoming a major area of concern among policymakers.

Brown signed AB 3757, authored by Assembly Speaker Willie Brown, to create the California State World Trade Commission. The same year, the Senate, under the leadership of then President pro Tempore David Roberti, organized a major international trade conference in Los Angeles.[2] As a result of these efforts, state government embarked on a strategy of increased emphasis on international trade, primarily focused on export promotion and attraction of foreign direct investment (FDI). The state's export finance (SB 1196, Vuich, 1984), export development (SB 1154, Alquist, 1987), and foreign office programs were all subsequently established during this period. AB 3313 (Moore) of 1984 required a study of the feasibility of opening one or more overseas offices. While the issue of FDI was somewhat controversial in the Legislature during the 1980s, it was included in the feasibility study that led to the establishment of the trade offices.

Governor Pete Wilson in 1992 signed SB 1909 (Vuich) to elevate international trade and economic development to a Cabinet-level position by creating the Trade and Commerce Agency.[3] This was formed by merging the Department of Commerce, which included the Office of Foreign Investment, with the World Trade Commission. The Commission's export finance and development offices, along with the foreign trade offices formerly under the auspices of the Governor's Office, rounded out the international side of the new agency.

In 1993, when the agency was established, the state had five foreign trade and investment offices dating from the second term of Governor George Deukmejian (whose tenure followed Jerry Brown's and preceded Pete Wilson's). Site selection of these offices was based on procedures outlined by Mentor International in the feasibility study required by the 1984 legislation. The Senate Office of Research in its 1993 report by Nick Vucinich cautioned that proposals for any new foreign offices should be reviewed carefully and that in some instances the state might want to consider consolidating overseas operations.

Controversy over Foreign Offices

As the foreign offices expanded to 12 under the Wilson and Davis administrations, a number of studies began raising issues about the mission and effectiveness of these offices. The offices were also often questioned by the Legislative Analyst's Office.

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[2] The conference was titled "California and International Trade: Partners in Economic Development."

[3] For a fuller review of the discussions and legislative history that led to the creation of the agency, see N. Vucinch, *Tapping New Markets*. It can be obtained from Senate Publications by calling 916-327-2155 and using order number 736-S.

In 1996, the state auditor found that the Trade and Commerce Agency lacked adequate tools for measuring the performance of its foreign trade offices. In a 2001 follow-up study, the auditor found that client-reported data on state exports and foreign investment might be inaccurate or incomplete. Private-sector trade associations, such as the California Council on International Trade and the Foreign Trade Association of Southern California, urged the state to bolster the capabilities of existing offices and adopt more focused export-development strategies rather than open new offices.

On the other hand, a study published in 1999 by the Institute of Governmental Studies at UC Berkeley stated that the foreign offices were understaffed and under-funded. Also that year, in a study commissioned for the agency by the California Research Bureau, it was noted that the agency had not sought the advice of actual exporters in preparing a location study for foreign offices in 1998.

The *Orange County Register* in a report of its investigation of the offices on May 25, 2003, raised concerns about whether the foreign trade offices had purposely misled lawmakers and the public about their effectiveness. This led to a hearing by the Senate Banking, Commerce and International Trade Committee on July 2, 2003, when directors of seven of the 12 offices were summoned to Sacramento to answer the charges raised in this investigation.

With all these concerns over such an extended period, it is not surprising that reviews of the effectiveness and mission of these offices would call into question the broader mission of the Technology, Trade and Commerce Agency. Back in 1993, Governor Pete Wilson's director of planning and research and chief economic advisor, Richard Sybert, had co-authored an article in the *Los Angeles Times* arguing that government should "provide only those services that the public desires and the market will not provide by itself, and to do so as efficiently as possible -- the way a profitable business would."[4] One of California's international programs, the California Export Finance Office, which served as a national model for export finance programs, clearly once met those criteria. But it, too, became caught up in the controversy over the trade offices and ultimately was eliminated.

It may be an exaggeration to state that controversy over the state's foreign trade offices led to the demise of the Technology, Trade and Commerce Agency. However, concerns about the effectiveness and accountability of these offices did much to undermine legislative support for the agency. Debate over the related issues of service delivery also raised difficult questions: Could trade-promotion programs have a significant impact on an economy the size of California's? Were the programs really needed and useful for business?

It should be noted that California was not alone in closing or reorganizing foreign offices. Among the states that have done so are Connecticut, New York, Texas,

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[4] Richard Sybert and Philip Romero, "Strive To Do It Better, Not Cheaper; Economy: Build On Our Strategic Location, Network Of World-Class Facilities and Abundance of Diverse Talent," Part two of three parts, " Recovery and Beyond: Reinventing California's Economy," *Los Angeles Times*, August 11, 1993.

Florida and Maine. According to the National Governor's Association, "states tend to jettison international programs during a budget crisis." The National Conference of State Legislatures has also drawn attention to widespread controversies over state-run foreign trade offices. According to NCSL, overseas trade offices can be costly to operate and at times pose managerial headaches. They also frequently served as a dumping ground for political appointees, most often by governors. Overseas offices often tend to lack clear guidance from the executive branch. Finally, these offices in many instances lack any clear predefined performance goals.

Is There a Role for State Government in the International Economy?

At this juncture, before attempting to design any new state international programs, it may serve us well to pose the question that Howard Shatz from the Public Policy Institute of California raised at SOR's February 14, 2002, roundtable on international trade: *How can California benefit from the global economy?* Shatz suggests that this is the relevant question, rather than asking how California can increase exports or attract more foreign investment. The National Governor's Association made much the same point in 2002 when it stated:

> *States must adopt broader international development goals that focus on competitiveness, market share and position, and value-added services. This will require a fundamental departure from most state's current systems, which focus primarily on promoting exports and direct foreign investment.*[5]

There is no question that the world economy has experienced dramatic changes, including more sophisticated technology, since the state first created the international programs that became the basis of the trade side of the Technology, Trade and Commerce Agency. Before focusing on developing specific trade-promotion programs, state policymakers may want to consider a broader investment strategy to assist California in more effectively competing in the global economy. This could include investment in education, health care and trade infrastructure such as ports, airports and highways. These are difficult issues given the state's fiscal situation, but there is rather broad agreement that these kinds of investments have the most impact on promoting the innovation and productivity that result in long-term prosperity.

Californians are still reaping benefits from what some have termed the "Eisenhower-Brown inheritance" -- federal spending for highways in the 1950s and the investment in the state's public education, particularly its system of higher education, associated with Governor Pat Brown in the 1960s. It is fairly easy to argue that the economic benefits produced by these investments have repaid their costs many times over.

At a minimum, state policymakers may want to consider some possible forums to focus attention on defining the role state government can play in promoting California's competitiveness in the global economy:

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[5] National Governors Association, *A Governor's Guide to Trade and Global Competitiveness,* Washington, D.C., 2002, pp. 13-14.

- Legislators may want to consider establishing a Joint Legislative Committee on Global Competition to recognize that the state's role in promoting competitiveness crosses areas of tax, education, transportation and economic development policy. In the wake of elimination of the Technology, Trade and Commerce Agency, this committee could play an important coordinating role for the Legislature and with the federal, local and private sector.

- California could establish representation on trade issues in Washington, D.C., as once existed under the California State World Trade Commission in the 1980s and early 1990s. As Jon Haveman of the Public Policy Institute of California has pointed out: "Although trade policies are set at the national rather than the state level, they are likely to be of greater consequence for California than for other states."[6] These policies affect opportunities available to California businesses and workers.

- State government could make better use of international trade expertise that already resides here among federal, private and non-profit entities. The Pacific Council on International Policy has identified over 60 centers, institutes and other entities in California, mostly housed at universities, that deal with aspects of international policy. Also included are U.S. Department of Commerce centers, local World Trade Centers, and Centers for International Trade Development at community colleges.

Further, the California State Senate Select Committee on Trade Policy is focusing on how international trade agreements can impact state laws and regulations. The California Economic Strategy Panel serves as a key forum in providing a framework for California investment in critical economic development areas, drawing together business, industry, labor, education and civic leaders to develop policy recommendations.

Despite these efforts, broader ones may be needed to find the most comprehensive answers to the question, "How can California benefit from the global economy?" As policymakers grapple with that issue, it may be beneficial for state government to have some kind of entity that can work with universities and public policy institutes to seek solutions.

--Prepared by Nick Vucinich

[6] Haveman, John D., *California's Vested Interest in U.S. Trade Liberalization Initiatives,* Public Policy Institute of California, San Francisco, California, 2001, p. 50.

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Also see http://members.tripod.com/jockoconnell/articles.html for many articles on the state's trade programs and policies by Jock O'Connell, a longtime observer and participant in California's international trade. O'Connell also worked for Lt. Governor Leo McCarthy in preparation of *An International Trade Policy For California,* presented to the California State World Trade Commission, September 26, 1986.